



Department of the Treasury
Internal Revenue Service
P.O. Box 2508
Cincinnati, OH 45201

Release Number: **201704020**
Release Date: 1/27/2017
UIL Code: 501.03-00
501.32-00
501.33-00

Date: November 1, 2016

Employer ID number:

Contact person/ID number:

Contact telephone number:

Form you must file:

Tax years:

Dear :

This letter is our final determination that you don't qualify for tax-exempt status under Section 501(c)(3) of the Internal Revenue Code (the Code). Recently, we sent you a proposed adverse determination in response to your application. The proposed adverse determination explained the facts, law, and basis for our conclusion, and it gave you 30 days to file a protest. Because we didn't receive a protest within the required 30 days, the proposed determination is now final.

Because you don't qualify as a tax-exempt organization under Section 501(c)(3) of the Code, donors can't deduct contributions to you under Section 170 of the Code. You must file federal income tax returns for the tax years listed at the top of this letter using the required form (also listed at the top of this letter) within 30 days of this letter unless you request an extension of time to file.

We'll make this final adverse determination letter and the proposed adverse determination letter available for public inspection (as required under Section 6110 of the Code) after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in the Notice 437 on how to notify us. If you agree with our deletions, you don't need to take any further action.

We'll also notify the appropriate state officials of our determination by sending them a copy of this final letter and the proposed determination letter (under Section 6104(c) of the Code). You should contact your state officials if you have questions about how this determination will affect your state responsibilities and requirements.

If you have questions about this letter, you can contact the person listed at the top of this letter. If you have questions about your federal income tax status and responsibilities, call our customer service number at 1-800-829-1040 (TTY 1-800-829-4933 for deaf or hard of hearing) or customer service for businesses at 1-800-829-4933.

Sincerely,

Jeffrey I. Cooper
Director, Exempt Organizations
Rulings and Agreements

Enclosures:

Notice 437

Redacted Letter 4036, *Proposed Adverse Determination Under IRC Section 501(c)(3)*

Redacted Letter 4038, *Final Adverse Determination Under IRC Section 501(c)(3) - No Protest*



Department of the Treasury
Internal Revenue Service
P.O. Box 2508
Cincinnati, OH 45201

Date: April 22, 2016

Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

Legend:

R = State

S = Date of formation

W = LLC

X = Governing body member

Y = Governing body member

m dollars = Amount

UIL:

501.03-00

501.32-00

501.33-00

Dear :

We considered your application for recognition of exemption from federal income tax under Section 501(a) of the Internal Revenue Code (the Code). Based on the information provided, we determined that you don't qualify for exemption under Section 501(c)(3) of the Code. This letter explains the basis for our conclusion. Please keep it for your records.

Issues

Do you qualify for exemption under Section 501(c)(3) of the Code? No, for the reasons stated below.

Facts

You were formed in the State of R on date S. X and Y are your sole governing body members and are responsible for all of your business activities.

Your stated purpose is to provide housing to persons with low to medium incomes. Your facility is a residential apartment building with 32 units. These 32 units include 19 one-bedroom units and 13 two-bedroom units. The one-bedroom units, which comprise 60% of your total units, will be rented to persons whose incomes do not exceed 60% of the area median income. The two-bedroom units, which comprise 40% of your total units, will be rented to persons whose incomes do not exceed 110% of the area median income, which is not considered low-income.

The facility is owned by a Limited Partnership (hereafter, "LP"). The LP was previously organized as an LLC, but was converted to a Limited Partnership. The LP has both Limited Partners and a General Partner. You are the General Partner of the LP. You, as General Partner, own 1% of the LP and the Limited Partners own 99%. The Limited Partners are W, X, and Y. W is a for-profit LLC. X and Y own 100% of W. W has a 76% ownership interest in the LP and the remaining 23% interest is held by X and Y (11.5% each).

The partnership agreement is valid for thirty-five years. You later state that the agreement is for sixty-five years. The agreement states that the partners shall share in the risks, benefits, profits and losses of these businesses and investments. The agreement also states that any income, deductions, gains, loss, or credit will be allocated proportionately among the partners according to their partnership interest and that no partner will have any priority over any other partner as to profits.

As General Partner you will hire and oversee the property manager who will collect rents and provide maintenance on the properties on a daily basis. You will participate in hiring and overseeing the work of the property management agent. The property manager is an unrelated property management company. X and Y will be the sole persons responsible for your business activities.

The partnership agreement also states that the Limited Partner, other than a Limited Partner who is also a General Partner, will have no vote in the LP's management and operations. The General Partner has the full and exclusive power to manage, control, administer and operate the business and affairs of the partnership. The duties of the General Partner are to annually conduct a physical inspection of the low income housing property to ensure it is being used for low income housing and that it meets all the requirements of the tax exemption for low income housing properties. The General Partner will submit a certification to the county assessor for this purpose.

In an amendment to the partnership agreement, you stated that as General Partner, in the event of any conflict to manage the LP, you will ensure all conduct and management will be performed consistent to the charitable purposes in the formative documents.

You participate in a local redevelopment plan. You state that by having exemption under Section 501(c)(3) of the Code, you will then qualify for reduced county property taxes which will make your operation financially feasible for the LP. The property tax reduction is estimated at m dollars annually. You said without this reduction the rental amounts would not be established as low as possible.

You will be sending fundraising letters to businesses and other organizations at least quarterly. You will also solicit donations via email and social media. You will apply for private and public foundation grants. Other than a small amount of gross investment income, you anticipate that all of your revenue will come from gifts, grants and contributions from the public.

You said the LP has operated at a "tax loss" since its inception, and in an amount exceeding \$100,000 two years ago. Even after eliminating the depreciation deduction, there has been a continual negative cash flow after making the bank loan payments. This deficit has historically been funded by the Limited Partners, which has allowed the operations to continue. Your proposed method of mitigating this loss is to seek exemption from property taxes. You said that even with the reduction in property taxes, additional funds may be required to continue the operation for the benefit of the homeless who are members of the public.

Law

Section 501(c)(3) of the Code provides for the exemption from federal income tax of corporations organized and operated exclusively for charitable or educational purposes, provided no part of the net earnings inures to the benefit of any private shareholder or individual.

Treasury Regulation Section 1.501(c)(3)-1(a)(1) provides that in order to be exempt under Section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the exempt purposes specified in that section. If an organization fails to meet either the organizational test or the operational test, it does not

qualify for exemption.

Treas. Reg. Section 1.501(c)(3)-1(c)(2) provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. Section 1.501(a)-1(c) of the regulations defines the words "private shareholder or individual" in Section 501 of the Code to refer to persons having a personal and private interest in the activities of the organization.

Treas. Reg. Section 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized and operated exclusively for an exempt purpose unless it serves a public rather than a private interest. Thus, to meet this requirement, it is necessary for an organization to establish that it is not organized for the benefit of private interests.

Rev. Rul. 98-15, 1998-12 I.R.B. 6, provides that for purposes of determining exemption under Section 501(c)(3), the activities of a partnership, including an LLC treated as a partnership for federal tax purposes, are considered to be the activities of the partners. A Section 501(c)(3) organization may form and participate in a partnership and meet the operational test if 1) participation in the partnership furthers a charitable purpose, and 2) the partnership arrangement permits the exempt organization to act exclusively in furtherance of its exempt purpose and only incidentally for the benefit of the for-profit partners.

Rev. Proc. 96-32, 1996-1 C.B. 717, sets forth a safe harbor under which organizations that provide low-income housing are considered charitable as relieving the poor and distressed, and a facts and circumstances test that applies in determining whether organizations that fall outside the safe harbor relieve the poor and distressed. The safe harbor is met if:

1. At least 75 percent of the units are occupied by families that qualify as low-income, and either at least 20 percent of the units are occupied by residents that are very low-income or at least 40 percent of the units are occupied by residents whose income do not exceed 120 percent of the area's very low-income limit.
 - The term "low-income" is defined under the Department of Housing and Urban Development ("HUD") guidelines as family income of no more than 80 percent of the median family gross income of the area, adjusted for family size.
 - The term "very low-income" is defined under HUD guidelines as family income of no more than 50 percent of the median family gross income of the area, adjusted for family size.
 - 120 percent of the area's very-low income limit equals 60 percent of the median family gross income of the area, adjusted for family size.
2. The project is actually occupied by poor and distressed residents.
3. The housing is affordable to the charitable beneficiaries.
4. If there are multiple buildings, the buildings must share the same grounds if they do not separately meet the 3 requirements listed above.

In est of Hawaii v. Commissioner, 71 T.C. 1067 (1979), aff'd in unpublished opinion 647 F.2d 170 (9th Cir. 1981) ("est of Hawaii"), several for-profit organizations exerted significant indirect control over est of Hawaii, a non-profit entity, through contractual arrangements. The Tax Court concluded that the for-profits were able to

use the non-profit as an "instrument" to further their for-profit purposes. Neither the fact that the for-profits lacked structural control over the organization nor the fact that amounts paid to the for-profit organizations under the contracts were reasonable affected the court's conclusion. Consequently, est of Hawaii did not qualify as an organization described in Section 501(c)(3).

In Basic Bible Church v. Commissioner, 74 T.C. 846 (1980), the organization's founder and his wife executed vows of poverty and transferred all their possessions and income to the organization on the condition that it qualified under IRC 501(c)(3). The founder controlled all financial decisions of the organization. The court found that a substantial purpose of the organization was to serve the private interests of the founder and his wife. Accordingly, the court held that the organization did not qualify under IRC 501(c)(3).

In Church by Mail, Inc. v. Commissioner (1985), the Court affirmed a Tax Court decision (T.C. 1984-349). Church by Mail sent out sermons in numerous mailings. This required a great deal of printing services. Twentieth Century Advertising Agency provided the printing and mailing. Twentieth Century was controlled by the same ministers. It also employed family members. The services were provided under two contracts. The contracts were signed by the two ministers for both Church by Mail and Twentieth Century. Church by Mail business comprised two-thirds of the business of Twentieth Century. In deciding for the government, the Court made the following statement: "There is ample evidence in the record to support the Tax Court's finding that the Church was operated for the substantial non-exempt purpose of providing a market for Twentieth's services."

In International Postgraduate Medical Foundation v. Commissioner, TCM 1989-36 (1989), the Tax Court considered the qualification for exemption under Section 501(c)(3) of the Code of a nonprofit corporation that conducted continuing medical education tours. The petitioner had three trustees: Mr. Helin, who was a shareholder and the president of H & C Tours, a for profit travel agency, Mr. Regan, an attorney, and a third director, who was ill and did not participate. Mr. Helin served as executive director. The petitioner used H & C Tours exclusively for all travel arrangements. There is no evidence that the petitioner ever sought a competitive bid. The Court found that a substantial purpose of the petitioner was benefiting the for-profit travel agency. It concluded that: "When a for-profit organization benefits substantially from the manner in which the activities of a related organization are carried on, the latter organization is not operated exclusively within the meaning of Section 501(c)(3), even if it furthers other exempt purposes." The court found that a substantial purpose of the applicant's operations was to increase the income of H&C Tours. H&C Tours benefits from the distribution and production of brochures which solicit customers for tours arranged by H&C Tours.

In Housing Pioneers, Inc. v. Commissioner, T.C.M. 1993-120, aff'd, 49 F.3d 1395 (9th Cir. 1995), amended, 58 F.3d 401 (9th Cir. 1995), a substantial nonexempt purpose was found where a nonprofit organization entered into limited partnerships with for-profit entities to operate low-income housing projects. While the nonprofit served as a co-general partner, its actual authority was narrowly circumscribed. The organization had no on-site management authority, no authority to screen or select tenants, and could describe only a vague charitable function of surveying tenant needs and ensuring that requirements for federal tax credits under Sections 38 and 42 of the Code were met. The organization had been formed to promote low-income housing, but the court found that the "keystone" of its plan was "achieving the objective of property tax reduction," and that it "has made no attempt to adopt any actual plan by which [it] expects to use its hoped-for share of property tax reductions to implement its stated objectives." The Tax Court concluded that the organization did not qualify under Section 501(c)(3) because it had a substantial non-exempt purpose and served private interests by conferring federal and State tax benefits on the for-profit partnership and partners, and therefore did not reach the Service's inurement argument based on the indirect participation by insiders in the partnerships. On appeal, the Ninth Circuit did not reach the inurement argument either, but held that the organization had a substantial non-exempt purpose because it failed to "materially participate" ... in the development and operation of the

project It has shown no regular, no continuous, no substantial activity in developing or operating the projects" and instead allowed the for-profit partners to control the activities.

Application of law

You are not exempt under Section 501(c)(3) of the Code. You fail the operational test because you are formed for the substantial non-exempt purpose of reducing the property taxes for the Limited Partners. Treas. Reg. Section 1.501(c)(3)-1(a)(1).

You were established to reduce the liabilities of a private business. Furthering private, rather than public, interests, does not further an exempt purpose. Treas. Reg. Section 1.501(c)(3)-1(d)(1)(ii). Also, like the organization discussed in Rev. Rul. 98-15, the Limited Partners use you for their own non-incidental private benefits, causing you to fail to be operated exclusively for exempt purposes and precluding exemption under Section 501(c)(3) of the Code.

If a private party is allowed to control or use the non-profit organization's activities or assets for the benefit of the private party, and the benefit is not incidental to the accomplishment of exempt purposes, the organization will fail to be operated exclusively for exempt purposes. See est of Hawaii. In this way you were formed specifically for the purpose of reducing the Limited Partners' property tax liability. As this is your primary purpose, your participation in the partnership is not in furtherance of an exempt purpose and you fail the operational test.

To be recognized as exempt from income tax under Section 501(c)(3) of the Code, a low-income housing organization must not only serve a charitable purpose but also meet the other requirements of that Section, including the prohibitions against inurement and impermissible private benefit. Prior to your formation, X and Y, as owners of a prior for-profit entity, were responsible for paying for all expenses of the housing project. You were formed to raise funds from the general public and pay for the expenses that X and Y were responsible for paying, which causes your earnings inure to the benefit of your founders. As described in Treas. Reg. Section 1.501(c)(3)-1(c)(2), you are not operated exclusively for one or more exempt purposes because your net earnings inure to X and Y.

Your two governing body members, X and Y, own the related for-profit organization, W, that stands to benefit directly from your existence. You are similar to Church by Mail because you are controlled by the same persons who control the for-profit company which conducts your programs. Your directors maintain dual control over both you and the for-profit organization. Like the organization described in Basic Bible, you were formed to serve the private interests of your founders and you are precluded from exemption under Section 501(c)(3) of the Code.

Similar to the organization described in International Postgraduate Medical Foundation, your founders are in positions of control and are co-owners of the related for-profit entity and partners in the LP. The Limited Partners benefit substantially from the manner in which your activities are conducted. Like this organization, you are not operated exclusively for exempt purposes within the meaning of Section 501(c)(3) of the Code because your earnings inure to the benefit of X and Y.

You are very similar to Housing Pioneers, which was formed to assist existing for-profit housing organizations acquire property tax exemption. They entered into partnerships with existing for-profit organizations that owned non-exempt housing for the purpose of splitting the tax benefits with for-profit partners. One of the housing organizations that would receive the tax benefit was owned by the founders and managers. In the same way, you were formed to receive a property tax benefit and your founders would receive the property tax

benefit from your exemption. Like this organization, you are seeking property tax reductions because the LP had been operating at a tax loss. X and Y have had to make ongoing contributions to keep the project operational. Your creation was for the specific purpose of seeking a reduction in property taxes to help fund the gap for which the Limited Partners are responsible. These reductions inure to the benefit of the non-exempt partners. Therefore, you are precluded from exemption under Section 501(c)(3) of the Code.

Additionally, you provided no information that indicates that you meet the required safe harbor guidelines for low-income housing as described in Rev. Proc. 96-32. You have not proven that more than 75% of your units are for low-income housing. In fact, 40% of your units are available to individuals with moderate income. Therefore, your activities are not charitable, as you have not met the safe harbor guidelines required for organizations operating low-income housing under Section 501(c)(3) of the Code.

Your position

You said to review Unitary Mission Church of Long Island v Commissioner, 74 T.C. 531 (1980), aff'd 670 F.2d 104 (9th Cir. 1981). It was ruled in this case that the mere concentration of power in one or a few persons does not justify disqualification of an entity, or due to inurement. You also referenced Rev. Rul. 70-186, 1970-1, C.B.0128. In that ruling it was determined that there could be some minor, incidental benefits to a private interest.

You request we take the following facts into account:

1. Only 1% share of the operating profits or losses of the LP is going to you. Accordingly, if there will ever be a taxable profit in the LP, there will be no sheltering of income attributable to the Limited Partners.
2. The LP does not shelter income through the payment of salaries, management fees, etc.
3. X and Y have invested close to a million dollars, directly or through W into you, and further personally guaranteed a bank loan of millions of dollars in order to create a low/medium income facility for the public.
4. No member of X and Y's family will ever directly, or indirectly use the premises.
5. The only income realized by you comes from low/medium income families in the form of controlled rents.
6. The LLC and LP have operated at a "tax loss" since their inception, including a six figure amount for a recent tax year. Even after eliminating the depreciation deduction, there has been a continual negative cash flow after making the bank loan payments. This deficit has been funded by the Limited Partners.
7. Currently the annual property taxes are approximately m dollars. The county has an exemption for property operated exclusively for low/medium income tenants. However, in order to be eligible you must be a 501(c)(3) entity.
8. Should you be recognized under Section 501(c)(3) of the Code, then the property tax exemption will enable you to have the necessary funds to continue to operate the low income housing, which is exclusively for the public benefit. There is no benefit inuring to any private individuals who are members or managers.
9. In order to qualify as tenant of the LP, there are limits on the respective incomes of those who would benefit. None of the LPs would fall into this category, only members of the public at large.
10. Finally, the LP employees, an onsite caretaker and an outside property management company, who whom the LPs have no connection. The General Partner's function does not benefit the Limited Partners in any way.

You said that you were organized to provide public housing for homeless and low-income persons who are members of the public. You were created and organized to aid and assist those persons with housing, not the creator, nor his family, shareholders or persons controlled directly or indirectly.

You said the Limited Partners acquired the LP for the purpose of providing housing to low/medium income families with affordable rents. X and Y have always had concerns related to the trials of the homeless and affordable housing.

The ability to continue the LP at a loss has required the ongoing contributions of funding by the Limited Partners. The method of mitigation is by way of the exemption of property taxes. Even with this reduction in property taxes, additional funds may be required to continue the operation for the benefit of the homeless who are members of the public.

The original for-profit was changed to an LP, and the General Partner is required to be an organization described in Section 501(c)(3) of the Code to achieve the objective of providing charitable benefits only to the public at large.

None of your activities inures to the benefit of any of the private shareholders, nor would any of its profits, if any, inure directly or indirectly, to any private person or shareholder or individual.

Our response to your position

Although you are correct that incidental private benefit is permissible, your only purpose is to provide tax benefits for the Limited Partners, and ultimately to X and Y. You are formed and operated for the purpose of reducing the tax liability of X and Y while they maintain control of the building. This is a substantial non-exempt purpose and results in private inurement to X and Y, precluding exemption under Section 501(c)(3) of the Code.

Conclusion

Based on the information provided, you do not qualify for exemption under Section 501(c)(3) of the Code. You operate for substantial non-exempt purposes and your operations inure to the benefit of your founders, which precludes you from exemption under Section 501(c)(3).

If you don't agree

You have a right to file a protest if you don't agree with our proposed adverse determination. To do so, you must send a statement to us within 30 days of the date of this letter. The statement must include:

- Your name, address, employer identification number (EIN), and a daytime phone number
- A copy of this letter highlighting the findings you disagree with
- An explanation of why you disagree, including any supporting documents
- The law or authority, if any, you are relying on
- The signature of an officer, director, trustee, or other official who is authorized to sign for the organization, or your authorized representative

- One of the following declarations:

For an officer, director, trustee, or other official who is authorized to sign for the organization:

Under penalties of perjury, I declare that I examined this protest statement, including accompanying documents, and to the best of my knowledge and belief, the statement contains all relevant facts and such facts are true, correct, and complete.

For authorized representatives:

Under penalties of perjury, I declare that I prepared this protest statement, including accompanying documents, and to the best of my knowledge and belief, the statement contains all relevant facts and such facts are true, correct, and complete.

Your representative (attorney, certified public accountant, or other individual enrolled to practice before the IRS) must file a Form 2848, *Power of Attorney and Declaration of Representative*, with us if he or she hasn't already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*.

We'll review your protest statement and decide if you provided a basis for us to reconsider our determination. If so, we'll continue to process your case considering the information you provided. If you haven't provided a basis for reconsideration, we'll forward your case to the Office of Appeals and notify you. You can find more information about the role of the Appeals Office in Publication 892, *How to Appeal an IRS Decision on Tax-Exempt Status*.

If you don't file a protest within 30 days, you can't seek a declaratory judgment in court at a later date because the law requires that you use the IRS administrative process first (Section 7428(b)(2) of the Code).

Where to send your protest

Please send your protest statement, Form 2848, if needed, and any supporting documents to the applicable address:

U.S. mail:

Internal Revenue Service
EO Determinations Quality Assurance
Room 7-008
P.O. Box 2508
Cincinnati, OH 45201

Street address for delivery service:

Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Room 7-008
Cincinnati, OH 45202

You can also fax your statement and supporting documents to the fax number listed at the top of this letter. If you fax your statement, please contact the person listed at the top of this letter to confirm that he or she received it.

If you agree

If you agree with our proposed adverse determination, you don't need to do anything. If we don't hear from you within 30 days, we'll issue a final adverse determination letter. That letter will provide information on your income tax filing requirements.

You can find all forms and publications mentioned in this letter on our website at www.irs.gov/formspubs. If you have questions, you can contact the person listed at the top of this letter.

Sincerely,

Jeffrey I. Cooper
Director, Exempt Organizations
Rulings and Agreements

Enclosure:
Publication 892